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In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-593

CENTRAL TABLET MANUFACTURING CO., PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (Pet. App. A 11-21)[1] is reported at 339 F. Supp. 1134. The opinion of the court of appeals (Pet. App. B 22-30) is reported at 481 F. 2d 954.

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[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari; "A." references are to the separately bound record appendix.

JURISDICTION

The judgment of the court of appeals was entered on August 7, 1973 (Pet. App. C 31). The petition for a writ of certiorari was filed on October 3, 1973, and was granted on December 17, 1973 (A. 58). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the gain realized by a corporation from insurance proceeds arising out of the involuntary conversion of its property by fire qualifies for nonrecognition under Section 337 of the Internal Revenue Code, where the fire occurred prior to the corporation's adoption of a plan of complete liquidation.

STATUTE INVOLVED

Section 337(a) of the Internal Revenue Code of 1954 is set forth at page 2 of petitioner's brief.

STATEMENT

Petitioner was in the business of manufacturing and selling educational and art supplies. On September 10, 1965, an accidental fire largely destroyed its equipment and building, none of which was subsequently repaired or replaced. The building and equipment were covered by fire and extended coverage insurance (Pet. App. A 11-12; Pet. App. B 23; A. 32).

The insurance company did not question either the validity of the insurance contracts or the fulfillment

of the conditions for payment. It did, however, dispute the exact amount to be paid under each policy.[2] Negotiation of the claims for the building and equipment began on or about November 1, 1965.

On May 14, 1966, petitioner's shareholders adopted a plan of complete liquidation and dissolution pursuant to Section 337 of the Internal Revenue Code of 1954. Six days later, petitioner accepted a settlement of its building insurance claim of $174,595.05, which was paid on June 15, 1966. On August 25, 1966, petitioner accepted a settlement of its personal property insurance claim of $104,609.27, which was paid to it on November 17, 1966 (Pet. App. A 12-13; Pet. App. B 24; A. 33-34).

Petitioner realized a gain upon the transaction because the amount of the insurance proceeds was greater than its adjusted bases in the various items of property destroyed. However, it excluded such gain from its taxable income under Section 337(a) of the Code (A. 35). Under that provision, no gain or loss is recognized by a corporation from the sale or exchange of its property within 12 months from the adoption of a plan of complete liquidation if all of its assets are distributed in liquidation within such 12-month period.

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[2] The insurer asserted the applicability of a co-insurance clause in the building insurance policy, and questioned the extent of the building loss, the value of the building at the time of loss, the value of the machinery and equipment that was lost or damaged, and the cost of repair of repairable machinery and equipment (Pet. App. A 12; Pet. App. B 23; A. 33).

On audit, the Commissioner of Internal Revenue determined that the nonrecognition provisions of Section 337 did not apply because the conversion of the property was at the time of its destruction by fire, which occurred prior to petitioner's adoption of a plan of complete liquidation (A. 34-35). The district court upheld petitioner's claim for refund on the ground that the relevant date for purposes of Section 337 was either the date that the insurance proceeds were received or when an enforceable settlement of a determined amount was reached, both of which occurred after the adoption of the liquidation plan (Pet. App. A 13-19). The court of appeals, however, unanimously reversed, holding that the critical date for purposes of Section 337 was when the fire occurred. It refused to construe the statute to permit nonrecognition of gain when property is destroyed before adoption of a plan of liquidation (Pet. App. B 25-30).

ARGUMENT

INTRODUCTION AND SUMMARY

1. Prior to the enactment of Section 337 of the Internal Revenue Code in 1954, it was not clear under what circumstances a corporation in the process of complete liquidation would be deemed to have made a sale of its property and when its shareholders would be viewed as having made the sale. Resolution of this question was important because this common type of transaction had different tax consequences depending upon the identity of the seller of the corporate

property. If the corporation made the sale, it would be taxable on the gain, and if the amount of the liquidating distributions exceeded the shareholders' bases in their stock, another tax would be imposed upon the shareholders. See Internal Revenue Code, Section 331(a)(1). If, however, the corporate property was first distributed in liquidation and the shareholders thereafter sold it, they would be taxed upon the difference between the value of the property and the bases of their stock but no gain would be taxable to the corporation.

Although it would appear that the identity of the seller in these circumstances would be a relatively simple matter to determine, two decisions of this Court made certainty in a corporate liquidation somewhat more difficult to achieve. In *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, the Court held that the liquidating corporation made the sale even though the corporate assets were previously distributed to the shareholders and they were named as the sellers in the contract of sale. The critical fact, in the Court's view, was that the negotiations for the sale of the property were conducted by the corporation prior to the distribution of its assets to the shareholders. Conversely, in *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451, the shareholders had first attempted to sell the stock of their corporation, but when the buyer refused to buy the stock, they offered to acquire the assets by liquidating the corporation and then to sell the assets. On these facts, the Court affirmed the Court of Claims' finding that

the shareholders and not the corporation had sold the assets.

After the *Court Holding* and *Cumberland Public Service Co.* decisions, it was no longer clear how shareholders might accomplish a sale of the property of their corporation so as to eliminate taxable gain to the corporation. As a result, the Senate Finance Committee at the time of the 1954 codification of the tax law observed that "[t]he result of these two decisions is that undue weight is accorded the formalities of the transaction and they, therefore, represent merely a trap for the unwary." S. Rep. No. 1622, 83rd Cong., 2d Sess., pp. 48-49. See also H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 38-39. In response to this problem, Section 337 was enacted "to provide a definitive rule which [would] eliminate the present uncertainties." S. Rep. No. 1622, *supra*, p. 258. It provides that if a corporation adopts a plan of complete liquidation and disposes of all its assets and liquidates within 12 months after the adoption of the plan, no gain or loss shall be recognized by the corporation from the sale or exchange by it of property within the 12-month period.

By its terms, the statute becomes operative only if the corporation "adopts a plan of complete liquidation" and distributes all of its assets in complete liquidation "within the 12-month period beginning on the date of the adoption of such plan." If these requirements are met, then the corporation does not recognize any gain or loss "from the sale or exchange by it of property within such 12-month period." A sale

or exchange can occur "within" the 12-month period only if it occurs subsequent to the adoption of the plan. Indeed, the only exception to this strict statutory rule is a minor one in the Regulations for sales made "before the adoption of the plan of liquidation if made on the same day such plan is adopted." Treasury Regulations, Section 1.337-1.

As a result of this rigid statutory requirement that sales occur within the 12-month period, in *Virginia Ice & Freezing Corp.* v. *Commissioner*, 30 T.C. 1251, the Tax Court, on finding that the taxpayer's sale of property was prior to the adoption of a plan of complete liquidation, held that the sale could not come within the nonrecognition provisions of Section 337 (a). See also *Whitson* v. *Rockwood*, 190 F. Supp. 478 (N. Dak.). Indeed, the paucity of cases on this point demonstrates that the statutory requirement is well understood to be absolute.

Under no circumstances, therefore, can Section 337 be construed to permit retroactive application of a plan of liquidation to cover the gain from a prior sale. Enforcement of the statutory requirement is enhanced by Section 6043(a) and Treasury Regulations, Section 1.337-6. Pursuant to those provisions, a corporation within 30 days of its adoption of a plan of liquidation must file with the Internal Revenue Service a copy of the plan, a statement of assets sold after the adoption of the plan and the dates of such sales, and information concerning the date of the final liquidating distribution. Receipt of such information by the Internal Revenue Service thereby re-

duces the likelihood that a taxpayer will claim that a plan was adopted earlier than it was in fact adopted in order to obtain nonrecognition treatment for the gain from a prior sale.[3]

2. In *Helvering* v. *Flaccus Leather Co.*, 313 U.S. 247, this Court held that a sum received by a taxpayer as proceeds of insurance on buildings and equipment destroyed by fire was not a gain from the "sale or exchange" of capital assets. In the Court's analysis, the destruction of property and the payment by an insurance company for its loss was simply a single transfer to compensate the owner. Such a transaction did not contain the reciprocal transfers which are necessary to show a sale or exchange. As a result of this decision, the Internal Revenue Service initially took the position that the involuntary conversion of property by fire and the subsequent receipt of insurance proceeds was not a "sale or exchange" within the meaning of Section 337. Rev. Rul. 56-372, 1956-2 Cum. Bull. 187.

The holding in *Flaccus Leather Co.* was changed by the enactment of Section 117(j) of the Internal

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[3] The Internal Revenue Service has ruled that failure to file the information return required by Section 6043 or the information required by Treasury Regulations, Section 1.337-6, will not automatically disqualify sales from Section 337 treatment. The ruling states, however, that a failure to do so may subject the taxpayer to the provisions of Section 7203 of the Code, which impose criminal penalties for willfull failure to supply information required by the Regulations. See Rev. Rul. 65-30, 1965-1 Cum. Bull. 155. Moreover, the failure to file this information may cause the Service to question whether or when a plan was adopted.

Revenue Code of 1939 (now Section 1231 of the 1954 Code), which permitted capital gains treatment for the net gains from involuntary conversions to the same extent as if they had been realized in sales or exchanges. On the basis of this amendment of one Code provision dealing with gains from involuntary conversions, two court decisions rejected the Service's ruling position that such gains were not from sales or exchanges for purposes of Section 337. These decisions indicated, however, that nonrecognition under such circumstances was permitted only where the destruction occurred subsequent to the adoption of a plan of liquidation. See *Towanda Textiles, Inc.* v. *United States*, 180 F. Supp. 373 (Ct. Cl.); *Kent Manufacturing Corp.* v. *Commissioner*, 288 F. 2d 812 (C.A. 4).[4]

In this limited sense, therefore, the scope of the statute was extended to encompass involuntary conversions as a result of fire or other destruction. In response to these adverse decisions, the Internal Revenue Service subsequently modified its position and treated an involuntary conversion resulting from the destruction of corporate property occurring after the adoption of a plan of liquidation as if it were a "sale or exchange" for purposes of Section 337(a). See Rev. Rul. 64-100, 1964-1 Cum. Bull. (Part 1) 130.

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[4] As we discuss *infra*, pp. 15-16, *Kent Manufacturing* involved a claim under Section 392 of the Code, a transition provision with respect to sales of property by a liquidating corporation during 1954.

3. The issue in this case involves the application of the strict statutory requirement that the adoption of the plan of liquidation precede the sale or exchange. It arises in the context of the involuntary conversion of insured property as a result of its destruction by fire prior to the adoption of the plan of liquidation. Subsequent to the fire, petitioner adopted a plan of liquidation. It seeks the benefits of the nonrecognition provisions of Section 337 on the ground that the agreement as to the amount of the insurance proceeds and the payment of its claim occurred after the adoption of the plan. The court of appeals, however, correctly held that the involuntary conversion of petitioner's property occurred upon its destruction by fire and not upon the subsequent agreement or the payment of the claim. Since the fire preceded the adoption of the liquidation plan, Section 337 was held to be inapplicable.[5] In so concluding, the decision below rejected the reasoning of the Eighth Circuit in *United States* v. *Morton*, 387 F. 2d 441.

Although such an involuntary conversion is now treated as if it were a "sale or exchange" for purposes of Section 337, it is plain, as this Court held in *Helvering* v. *Flaccus eather Co.*, *supra*, that it is not identical to a sale or exchange. Nevertheless, the

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[5] There is no question that the liquidation was completed within the 12-month period. On May 3, 1967, the remaining assets, after liquidating distributions to the shareholders, were transferred to a national bank as trustee to meet claims against petitioner. On the same date, petitioner was dissolved under Ohio law (Pet. App. A 13; Pet. App. B 24; A. 34).

judicial extension of Section 337 to this type of involuntary conversion requires that analogies be drawn to other transactions where a transfer of ownership occurs.

An involuntary conversion arising out of a condemnation offers the closest analogy. With respect to such condemnations, the appellate courts, including the Eighth Circuit, have uniformly held that the involuntary "sale" for purposes of Section 337 occurs upon the initial taking of the property and not upon either the reaching of an agreement as to the amount of the condemnation award or its ultimate payment. The courts have so concluded even though a taking of property by condemnation, like the fire in this case, can occur without warning so as to prevent the timely adoption of a liquidation plan. Thus, as the decision below observed, to permit nonrecognition treatment where the destruction preceded the adoption of a plan would accord petitioner the advantage of hindsight unavailable in either an involuntary conversion by condemnation or in the usual type of sale or exchange.

There is no basis for the Eighth Circuit's decision in *Morton* that the involuntary "sale" arising out of the destruction of property occurs when the amount of the insurance proceeds is either agreed upon or paid. Unlike the moment of destruction, which can be easily ascertained, the subjective nature of the determination of when an agreement is reached would reintroduce the uncertainty in the corporate liquida-

tion process which the enactment of Section 337 was intended to eliminate.

To the extent an analogy can be drawn to the usual type of sale, both the destruction of property here and the usual type of transfer by sale operate to terminate the ownership relation with respect to property. Moreover, it is well established that a sale can occur for tax purposes long before the amount of the consideration can be ascertained. There is accordingly no justification for postponing the "sale" for purposes of the statute to the point at which the amount of insurance compensation is determined.

Finally, petitioner's position is in conflict with the undisputed rule that a taxpayer's holding period of property is coterminous with his ownership rights and that both terminate upon the destruction of the property. If, as petitioner contends, the relevant date for purposes of Section 337 was when agreement was reached regarding the amount of insurance to be paid, the questionable conclusion follows that the "sale" occurred long after the termination of petitioner's holding period and ownership. The operative event, therefore, necessarily must be the fire.

THE GAIN REALIZED BY A CORPORATION FROM INSURANCE PROCEEDS ARISING OUT OF THE INVOLUNTARY CONVERSION OF ITS PROPERTY BY FIRE DOES NOT QUALIFY FOR NONRECOGNITION UNDER SECTION 337 OF THE CODE, WHERE THE FIRE OCCURRED PRIOR TO THE CORPORATION'S ADOPTION OF A PLAN OF COMPLETE LIQUIDATION

A. The judicial extensions of Section 337 to involuntary conversions from destruction require that the plan of liquidation precede the destructive event

In enacting Section 337 to eliminate the need to identify the seller of corporate property in the course of a complete liquidation, it seems fair to conclude that Congress did not speak to the question whether gains from involuntary conversions were to be eligible for nonrecognition treatment. But Congress was surely aware of the general tax problems caused by involuntary conversions, for, as early as the Revenue Act of 1921,* the taxing statutes had provided for nonrecognition of gain from involuntary conversions where the property was replaced within a specific period of time. Because there is no reference to involuntary conversions by destruction in either the terms of Section 337 or in its legislative history which would support their inclusion into the statutory term "sale or exchange," there was certainly a

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* See Revenue Act of 1921, c. 136, 42 Stat. 227, Sections 214 (a) (12) and 234 (14), relating to individuals and corporations respectively. Although there have been changes in the statute with respect to the specific requirements for qualification, the basic nonrecognition principle survives in Section 1033 of the present Code.

persuasive case that Section 337 was not meant to apply in such circumstances. Nevertheless, the courts reasoned that Congress would not have excluded involuntary conversions arising from the destruction of insured property had it addressed the problem, and the Service announced its acceptance of these holdings.[7]

In so concluding, however, both the Court of Claims in *Towanda Textiles, Inc.* v. *United States*, *supra*, 180 F. Supp. 373, and the Fourth Circuit in *Kent Manufacturing Corp.* v. *Commissioner*, *supra*, 288 F. 2d 812, indicated that Section 337 required the adoption of the plan of liquidation to precede the destruction of the property. Thus, in *Towanda Textiles*, where the fire occurred three days after the adoption of the plan, the court stated that "It is not conceivable that Congress would have drawn a distinction between a gain from a voluntary conversion and an involuntary one, *had the possibility of an involuntary conversion during liquidation* come to its attention" (180 F. Supp. at 376) (emphasis supplied). The court's reference to a conversion "during" liquidation, coupled with the fact that the plan in that

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[7] The rationale of the decisions was grounded solely on Section 117(j) of the 1939 Code (now Section 1231 of the 1954 Code), providing that net gains from involuntary conversions of property used in trade or business shall be considered as gains from sales or exchanges of capital assets held for more than six months. While relying on this statute, the Court of Claims in *Towanda Textiles* nevertheless acknowledged that "Literally, an involuntary conversion is not a sale * * *" (180 F. Supp. at 376).

case was adopted prior to the fire, necessarily suggests its agreement with the proposition that the destruction of the property must occur after the commencement of the liquidation process, which can only be manifested by the adoption of a liquidation plan.

Similarly, the Fourth Circuit in *Kent Manufacturing Corp.* indicated that Section 337 requires that the liquidation plan precede the destruction of the property. There, both the destruction of the property and the payment of the insurance claim preceded the adoption of the liquidation plan. Although the court sustained the taxpayer's claim to nonrecognition treatment, it did so only because the transaction qualified under Section 392(b). That provision was enacted together with Section 337 in the 1954 Code to provide a transition from the 1939 Code, which contained no rule comparable to Section 337. Under Section 392(b), a liquidating corporation which made sales of its property during 1954 before the passage of Section 337 could elect nonrecognition treatment for the gain on such sales as long as it distributed all of its assets in complete liquidation before January 1, 1955. Significantly, however, the court specifically agreed with the Commissioner that Section 337 did not apply to the transaction "because the conversion did not occur and the gain was not realized *in the course of a previously planned liquidation*" (emphasis supplied) (288 F. 2d at 816).

By distinguishing between the initial "conversion" (destruction) of the property and the subsequent realization of gain (receipt of the insurance pro-

ceeds), and stating that both events must occur after the adoption of the plan, *Kent Manufacturing* correctly recognized, as the decision below held, that Section 337 applies only when the adoption of the liquidation plan precedes the destruction of the property. If, as in this case, the sequence of events had been the destruction, the adoption of the plan, and then the receipt of the insurance funds, the Fourth Circuit would not have regarded the fact that the insurance proceeds were received after the adoption of the plan as sufficient to invoke the application of the statute.

We submit that these observations by the very decisions which extended Section 337 to cover involuntary conversions by destruction correctly interpret the statutory terms to exclude the case where, as here, the destruction precedes the plan of liquidation. The holding of the Court of Claims in *Towanda Textiles* can perhaps be most easily explained on the basis of equality of treatment for all corporate gains and losses from property arising after the adoption of the plan of liquidation. If a corporation adopts a liquidation plan and thereafter its property is destroyed before it has an opportunity to dispose of it by sale or exchange, it is arguably harsh to withhold the benefits of nonrecognition.

But this rationale has no application to this case, where allowance of nonrecognition would accord preferential treatment for conversions by destruction occurring prior to the adoption of the liquidation plan over the usual type of sale or exchange which must

take place after the adoption of the plan. As the court of appeals correctly observed (Pet. App. B 30): "To expand the statute further by construing it to permit nonrecognition when the property is destroyed before adoption of a plan of liquidation would, instead of preventing injustice to a taxpayer that had decided to liquidate, give it an advantage over other taxpayers by permitting it to decide after destruction of the property whether to rebuild with insurance proceeds or to liquidate."

B. The destruction of petitioner's property by fire is analogous to the initial taking of property in an involuntary conversion by condemnation

As we have noted, the payment by an insurance company of a claim in connection with the destruction of property represents a unique category of involuntary conversion for purposes of Section 337 insofar as it does not involve any transfer of ownership. To the extent that analogies can be drawn, however, there are close parallels between this case and an involuntary conversion by condemnation where a transfer of ownership does occur. A casualty involves a sudden event, as can a condemnation (see, *e.g.*, *Dwight* v. *United States*, 328 F. 2d 973 (C.A. 2)), and both events create a claim for compensation by the owner of the property against either an insurance company or the condemning governmental authority. In both cases, the event can occur without prior warning and before the corporation is able to adopt a plan of complete liquidation.

Despite the inability of the taxpayer to act quickly under such circumstances, the courts of appeals, including the Eighth Circuit, have uniformly held that a corporation is not entitled to the benefits of Section 337 when the condemnation occurs prior to the adoption of the plan. See, *e.g.*, *Wendell* v. *Commissioner*, 326 F. 2d 600 (C.A. 2); *Dwight* v. *United States*, *supra*; *Covered Wagon, Inc.* v. *Commissioner*, 369 F. 2d 629 (C.A. 8); *Likins-Foster Honolulu Corp.* v. *Commissioner*, 417 F. 2d 285, 290 (C.A. 10), certiorari denied, 397 U.S. 987. Thus, for example, in *Dwight* v. *United States*, *supra*, the Second Circuit held that the gain was realized upon the condemnation of the property and not when the award was ultimately paid. Recognizing that "the corporation had no opportunity to adopt a plan of liquidation before condemnation, and [that] the conditions of section 337 could not be met," the court observed that "[t]his may appear a harsh result, but if it is to be corrected Congress must act; the courts have no power to do so" (328 F. 2d at 974).*

Significantly, in all of the decisions involving involuntary conversions by condemnation, the operative "sale or exchange" for purposes of Section 337 was

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* In 1959, Congress was urged to provide an exception to the absolute statutory requirement by extending Section 337 to cover all types of involuntary conversions occurring prior to the adoption of a liquidation plan, but it never acted on the proposal. See Hearings before the House Ways and Means Committee, on Advisory Group Recommendations on Subchapters C, J and K of the Internal Revenue Code, 86th Cong., 1st Sess., pp. 473, 532.

uniformly held to have occurred when the incidents of ownership of the property passed from the taxpayer to the condemning authority. Contrary to the statement of the district court in *Kinney* v. *United States*, 73-1 U.S.T.C. ¶ 9140 (decided November 10, 1972 (N.D. Cal.), on appeal to the Court of Appeals for the Ninth Circuit), upon which petitioner relies (Br. 11), the condemnation decisions so held even though the amounts of compensation the taxpayers were to receive had not yet been determined.[9] Thus, just as the "sale or exchange" in the condemnation cases arose upon the taking of the property and did not depend upon the ultimate agreement as to the award or its payment, so did the judicially-created "sale or exchange" of petitioner's property occur upon its destruction and not when the amount of the

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[9] Condemnation statutes differ. While some require that the amount of compensation be fixed before the condemning authority has the right to take the property, others provide that the filing of a notice of taking transfers ownership to the condemning authority. For purposes of Section 337, however, the consistent rule is that the conversion occurs when the taxpayer is required by local law to part with the incidents of ownership in the property and receive in substitution a right to compensation, regardless of whether or not the precise amount of compensation has been determined at that time. See Rev. Rul. 59-108, 1959-1 Cum. Bull. 72.

Cf. *Mountain Water Co. of La Crescenta* v. *Commissioner*, 35 T.C. 418, acquiescence, 1961-1 Cum. Bull. 4. There, the transfer of the property to the condemning authority did not occur under the local procedure until the taxpayer agreed to accept the amount of a court-determined award. The Tax Court found as a fact that at that point in time a plan of liquidation had been adopted.

insurance claim was subsequently agreed upon or paid.

For purposes of Section 337, there is no difference between a corporation which has parted with the incidents of ownership of its property as a result of a taking by condemnation and one which has suffered the destruction of property covered by insurance. In both cases, the corporation's prior relationship to the property has been irrevocably terminated and transformed into a claim for compensation. Unless such a transformation occurs subsequent to the adoption of the liquidation plan, the nonrecognition provisions of Section 337 are inapplicable.

C. The involuntary conversion as a result of a fire loss is not postponed beyond the time of the fire even though no transfer of ownership is involved.

In contending that the date of the involuntary conversion of its destroyed property was subsequent to the adoption of a liquidation plan, petitioner relies principally (Br. 8-12) upon the decision of the Eighth Circuit in *United States* v. *Morton*, 387 F. 2d 441, and of the district court in *Kinney* v. *United States*, 73-1 U.S.T.C. ¶ 9140 (decided November 10, 1972 (N.D. Cal.), on appeal to the Court of Appeals for the Ninth Circuit). Petitioner however, appears unable to settle upon any one particular event in the sequence from destruction to ultimate payment of the claim. Thus, for example, it first contends (Br. 9) that the conversion occurs when a formula is established for the measurement of the insured loss. It next urges (Br. 10) that the conversion arises

when the insurer accepts the proof of loss. Finally, it proposes yet another theory (Br. 10), that the relevant event is the payment of the insurance claim.

Such uncertainty on the part of petitioner is hardly surprising in view of the divergence of approach between the *Morton* and *Kinney* decisions themselves. In *Morton*, the court held that "[s]ince no title is involved in a fire loss case of this type, we think the catastrophe is but the commencement of an involuntary conversion that does not come into fruition until, at least, the amount to be received by way of reimbursement for that loss is decided either by agreement or by court action" (387 F. 2d at 447). In marked contrast, however, the district court in *Kinney* concluded that "under the insurance policy until the proof of loss had been submitted and accepted by the insuror, there was no legally enforceable right to the proceeds accruing to the taxpayer" (73-1 U.S.T.C. at 80,131).[10]

The applicability of Section 337, a provision designed to bring objective certainty into the corporate liquidation process, should not turn upon the subjective inquiry required by *Morton* as to when an agree-

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[10] Unlike *Morton* where the agreement respecting the amount of insurance payable was reached after the adoption of the plan, such an agreement was reached in *Kinney* prior to the plan of liquidation (73-1 U.S.T.C. at 80,128). Thus, the court in *Kinney* could not have held for the taxpayer had it strictly followed the *Morton* rationale. It viewed the filing of the proof of loss with the insurer, which occurred subsequently to the adoption of the plan, as the pertinent event under Section 337.

ment respecting compensation is reached between the taxpayer and the insurer. Unlike the time of the casualty, which is, for the most part, easily and objectively ascertained, there is great potential for disagreement among triers of fact in applying the *Morton* standard.[11] Indeed, Section 337 was enacted to eliminate the confusion caused by disagreement among finders of fact. Compare *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451, 454, n. 3, with *Commissioner* v. *Court Holding Co.*, 324 U.S. 331. The *Morton* standard would reintroduce the same type of uncertainty which existed prior to 1954 with respect to conversions arising from casualties.[12]

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[11] The inquiry required by the district court in *Kinney* as to when the proof of loss is "submitted and accepted" is similarly subjective in nature.

[12] Since Section 337 precludes the recognition of losses after the adoption of a liquidation plan, the uncertainty of when an "agreement" is reached under the *Morton* rationale could well work a hardship upon taxpayers. For example, suppose a corporation suffers a loss of a major asset with a basis of $100,000. Although it is uncertain as to the amount the insurer will pay, it submits a claim for $200,000. After considerable discussion, however, the insurance company "agrees" to pay $25,000 in compensation. If the corporation thereafter decides to liquidate and wishes to obtain Section 337 treatment with respect to other assets it can sell at a gain, it is unclear at what point it should adopt the plan of liquidation. It cannot adopt the plan before it ascertains whether the insurance proceeds will produce gain or a loss. To do so will preclude recognition of the possible loss. Similarly, it cannot wait to adopt the plan until after the amount of insurance is ascertained without risking the possibility of having to recognize a possible gain if the insurer pays the entire claim. By fixing the casualty as the "sale" for Section 337 purposes, the decision

Moreover, the *Morton* rule would create a difference in treatment between involuntary conversions by condemnation and those arising by casualty. In the Eighth Circuit's view, such a difference is justified because a condemnation involves a transfer of ownership while a casualty does not. But this, we submit, is a distinction without a difference for purposes of Section 337.

The fact that the statutory term "sale or exchange" has been extended by the courts to encompass involuntary conversions resulting from destruction of property requires the selection of the single event which most closely corresponds to the point at which a sale or exchange occurs, *viz.*, when the benefits and burdens of ownership are transferred so as to terminate the seller's relationship to the property. See *e.g.*, *Lucas* v. *North Texas Co.*, 281 U.S. 11; *Boykin* v. *Commissioner*, 344 F. 2d 889 (C.A. 5); *Wiseman* v. *Scruggs*, 281 F. 2d 900 (C.A. 10); *Commissioner* v. *Baertschi*, 412 F. 2d 494 (C.A. 6). The destruction by fire of petitioner's property terminated the relationship it maintained with respect to the property just as if it had transferred the incidents of ownership by sale or condemnation. In all cases, continued use by the owner is no longer possible.

Petitioner, however, argues (Br. 10) that the agreement as to the amount of the insurance proceeds is the point at which the "sale" occurs because the usu-

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below provides a uniform rule of certainty which allows the recognition of losses under such circumstances and requires the recognition of gains.

al type of sale does not arise until the price is determined. This analogy is unsound because it confuses the concept of a sale with the realization of gain or loss from a sale.

There are many situations where the amount of the sales price is subject to future contingencies so that the precise amount of gain or loss cannot be ascertained at the time of transfer of ownership. Despite this fact, a sale has nevertheless occurred for tax purposes. See, *e.g.*, *Burnet* v. *Logan*, 283 U.S. 404; *Gralapp* v. *United States*, 458 F. 2d 1158 (C.A. 10); *United States* v. *Jones*, 194 F. 2d 783 (C.A. 10); *Estate of Marshall* v. *Commissioner*, 20 T.C. 979; and *Cluff* v. *Commissioner*, 17 T.C. 225.[13] Thus, the computation of the sales price after the contingencies have occurred is wholly separate and apart from the sale itself.

Similarly, here, the occurrence of the fire created an unconditional obligation by the insurer to pay compensation in accordance with the contract of insurance. The subsequent agreement as to the amount of the compensation is simply an application of the policy provisions to the specific facts of the case. In

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[13] By way of further illustration, it is quite common for one corporation to acquire the stock of another corporation in exchange for a fixed number of shares of the acquiring corporation's stock plus a contingent number of shares based upon either the future market price of the shares or upon the future earnings of the acquired corporation. The Service has ruled that such transactions are exchanges which are nontaxable under Section 368(a)(1)(B). See Rev. Rul. 66-112, 1966-1 Cum. Bull. 68; Rev. Rul. 67-90, 1967-1 Cum. Bull. 79.

that sense, it is analogous to the computation of a sales price under a contigency formula.[14]

Finally, petitioner's position and that of the Eighth Circuit in *Morton* is inconsistent with the rules governing the holding period of property for purposes of measuring whether the gain from the sale of a capital asset is taxable as short-term or long-term capital gain. See Section 1222 of the Code. In *McFeely* v. *Commissioner*, 296 U.S. 102, 107, this Court ruled that a taxpayer's holding period with respect to property was coterminous with the period of his ownership.[15] It was subsequently held with respect to a condemnation that the taxpayer's holding period ends with the transfer of ownership to the condemning authority. *Commissioner* v. *Kieselbach*, 127 F. 2d 359, 363 (C.A. 3), affirmed on another issue, 317 U.S. 399.

Similarly, in the case of a conversion by destruction, the taxpayer's holding period ends with the destruction. *Steele* v. *United States*, 52-2 U.S.T.C. ¶ 9451, decided March 25, 1952 (S.D. Fla.); *Rose* v. *United States*, 229 F. Supp. 298, 300 (S.D. Cal.). In those cases, involving sunken ships, the courts rejected the taxpayers' attempts, similar to that of

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[14] Petitioner further contends (Br. 10) that the fire is comparable to an executory contract of sale which is executed only when the amount of insurance is payable. But in an executory contract, the position of the parties may be restored to *status quo ante*. This is not possible, however, where the property has been destroyed.

[15] See also *Hooper* v. *Commissioner*, 26 B.T.A. 758, and I.T. 3287, 1939-1 Cum. Bull. (Part 1) 138.

petitioner, to postpone the dispositive event beyond the casualty to the time when they abandoned the property and were compensated by the insurer. In light of these holdings, the correctness of which are not in dispute,[16] petitioner's position is reduced to the questionable proposition that the "sale" of its property for purposes of Section 337 took place long after its ownership and holding period had ended. The "sale," therefore, must be deemed to have occurred at the time petitioner's property was destroyed by fire.

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[16] The Eighth Circuit in *Morton* acknowledged that these cases are "sound as it would be difficult to hold a capital asset after its destruction * * *." It noted, however, that they "appear to be of limited relevance in determining when a sale or exchange has taken place in the event of an involuntary conversion of a capital asset through destruction" (387 F.2d at 446).

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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